No. 8947

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

WILLIAM KING WHITE, ELIZABETH WHITE KING, ROLLIN HENRY WHITE, JR., R. H. WHITE and KATHERINE KING WHITE,

Appellants,

vs.

PENELAS MINING COMPANY (a corporation), Debtor,

Appellee.

APPELLANTS' REPLY BRIEF ON MERITS AND MOTION TO DISMISS.

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Reply Brief on Merits.

APPELLANTS' ASSIGNMENT NO. I.

THE DEBTOR'S PETITION SHOULD HAVE BEEN DISMISSED BECAUSE NOT AUTHORIZED BY THE BOARD OF DIRECTORS.

In the opening brief of appellants herein it was pointed out that the record in the District Court disclosed that no meeting of the Board of Directors of the debtor corporation had ever been held authorizing the filing of the petition for reorganization and that the certificate of the secretary attached to the peti-

tion certifying to a resolution allegedly passed at a meeting allegedly held on the 2nd of May, 1938, was false and that this record was fabricated (Appellants' Opening Brief, pages 14 to 20-22). Appellants' opening brief further pointed out that no valid meeting could have been held for the reason that the record conclusively established that no notice, as required by the debtor's by-laws, of any alleged meeting had ever been given to president and director White (Appellants' Opening Brief, pages 16, 17). The evidence established that the two remaining directors of the debtor corporation purposely withheld from him any knowledge that the debtor corporation had allegedly taken steps preparatory to filing a petition for reorganization under the provisions of Section 77B of the Bankruptcy Act (R. 126, 127). In this situation, appellants contend that the petition filed in the District Court was without any authorization from the corporation and should have been dismissed.

Appelle argues:

(a) That there is some evidence in the record that the corporate meeting was held as certified by the secretary in the certificate attached to debtor's petition;

(b) That the giving of notice to director White was unnecessary; and

(c) That a majority of the Board of Directors could authorize the filing of the petition in bankruptcy without a meeting as a board.

EVIDENCE IN DISTRICT COURT OF HOLDING OF CORPORATE MEETING.

An examination of the evidence produced in the District Court on the question of the authorization of the petition by the Board of Directors of the debtor corporation will show that director Gordon was called as a witness on behalf of the debtor and the following proceeding took place:

> "Mr. Gordon was then shown what purported to be the corporate minute book of the Penelas Mining Company and his attention called to pages 1 and 2 entitled 'Regular Monthly Meeting of the Directors, Penelas Mining Company', and to the resolutions on pages 1 and 2. He then testified, in substance, that the signatures appearing on page 2, 'L. D. Gordon, Chairman' and 'Attest Walter Rowson' were the signatures of the persons named. That he was present at a regular meeting of the Penelas Mining Company at which those resolutions were adopted on May 2, 1938. Those resolutions were in fact adopted, at which time the following matters took place:
>
> 'Q. Kindly read them and state——
>
> Mr. Thatcher. Let us see them first.
>
> Mr. Rowson. I want the witness himself to read them and identify them as correctly reciting the resolutions that were adopted that date.
>
> Mr. Thatcher. We would like to ask a few questions on voir dire.
>
> Q. (Mr. Thatcher). Do I understand, Mr. Rowson, you will take the stand for the purpose of this identification?
>
> Mr. Rowson. Yes sir.' "
>
> (R. 116, 117.)

Thereupon, Mr. Rowson, the secretary of the corporation, assumed the witness stand and testified concerning the alleged meeting. In the course of this testimony he testified as follows:

"Q. The time you prepared that (referring to the draft of the debtor's petition purporting to be adopted at the alleged meeting) was the time of Mr. Gordon's last visit to Cleveland?

A. I drafted it, yes.

Q. That is when you prepared your first draft for this petition?

A. Yes, with the expectation of presenting it at the regular meeting of directors.

Q. And that was while Mr. Gordon was in Cleveland on his last visit to Cleveland for a conference with Mr. White?

A. Yes.

Q. Do you know when—and that date is definite in your mind?

A. April 20th.

Q. No, I say the time—was the time when you received a wire from Mr. Gordon?

A. Yes, I think the date was April 20th, as I recall.

Q. But you do know that you drafted it as a result of a wire that you received from Mr. Gordon?

A. Yes.

Q. You are sure of that?

A. I am sure of that yes. I am sure of it."

(R. 131.)

and also testified as follows:

"Q. When Mr. Little was here, you had not at that time prepared any draft of the petition?

A. No, I had not.

Q. You had merely considered a possibility?

A. Merely considered and discussed it with him; told him I wanted to be very frank about the matter. I didn't figure the company was sunk, that it had available means to which it could resort and mentioned to him specifically 77B of the Corporate Reorganization Act.

Q. However, at that time you had not prepared any draft of a petition?

A. No.

Q. And no meeting had been held authorizing it?

A. No.

Mr. Thatcher. I think that concludes my examination of Captain Rowson. If he desires to cross-examine himself——"

(R. 132.)

Mr. Gordon then resumed the stand and testified he was present at the directors' meeting testified to on the examination of Mr. Rowson (R. 137). During the course of Mr. Gordon's testimony later, he testified he had wired Rowson, saying:

"I have tried everything humanly possible but no luck." (R. 164.)

Gordon was then asked to produce the telegram that he sent to Rowson and when the telegram was produced it disclosed its date as May 20, 1938 (R. 165). Rowson replied by wire, dated the same day:

"Have everything ready file petition Federal Court tomorrow." (R. 165.)

When this appeared and the telegram dated May 20, 1938 was produced, Rowson then asked that his testi-

mony be corrected to show that the petition was first drafted May 20, 1938, instead of in April (R. 165). The attorney for appellants then asked Mr. Rowson how he explained the resolution passed on the 2nd of May, 1938, which stated that the petition was considered by the board and how he would reconcile it with the previous testimony of the morning (R. 166). Rowson then said he would have to refer to his journal before correcting the testimony on that point (R. 166). The journal was never produced, although demanded.

> "Evidence withheld by a party is presumed to be adverse to him."
>
> *Nichols' Applied Evidence,* Vol. 2, page 1735.

The series of telegrams between Rowson and Little (R. 469, 470) and between Little and White (R. 470) show conclusively the time of Little's visit to Reno as May the 12th.

It requires very little imagination to perceive that these minutes were written up and back-dated after the negotiations collapsed in Cleveland and were prepared as the result of the telegram of May 20, 1938, to Rowson from Gordon.

It was pointed out in appellants' opening brief that under the Nevada law the government of the affairs of a Nevada corporation is vested in its Board of Directors, and if there was no meeting of that corporation held, the filing of the petition in this proceeding was wholly invalid. A number of Nevada cases supporting this doctrine were cited therein.

In the answering brief of appellee, it is stated:

> "As against the earlier decisions of the Nevada Supreme Court * * * cited by appellants * * * the more recent decisions of the Nevada Court recognize the power of a majority of the directors to act authoritatively for the corporation." (Appellee's Brief, page 65),

citing

> *Defanti v. Allen Clark Co.,* 45 Nev. 120, 198 Pac. 549.

Appellee then quotes from the Defanti decision, but fails to quote the whole of the pertinent language. Immediately following the language quoted by appellee, we find the following in the Defanti opinion:

> "Without reviewing the familiar reasons for the necessity of such a regulation for the proper conduct of the business and affairs of a corporation, it must be conceded that a mortgage authorized at a special meeting of the board of directors, of which no notice was given its third member, is an invalid act."

The Defanti decision does not support the contention of appellee, but holds the exact contrary.

In the answering brief of appellee it is contended that the position of director White was antagonistic to that of the remaining directors and that therefore a notice was unnecessary. 14A *Corpus Juris,* Section 1846, is cited as authority for this statement of the law. The Corpus Juris note cites *In re Kenwood Ice Company,* 189 Fed. 525. Upon appeal (204 Fed. 577) the Circuit Court of Appeals held that no notice need

be given to a director who had abandoned his office as a director and no longer held such office.

It is further urged in appellee's brief that appellants' petition in the present case did not raise an issue regarding the filing of the petition without the authority of the Board of Directors. The petition in intervention, however, shows to the contrary (R. 26).

APPELLANTS' ASSIGNMENT NO. II.

THE PETITION OF DEBTOR SHOULD HAVE BEEN DISMISSED FOR LACK OF GOOD FAITH.

In the opening brief of appellants it was urged that the District Court erred in refusing to dismiss the debtor's petition for the reason that the petition was not filed in good faith in that:

(a) No basis existed for expecting a reorganization and there existed no probabilities of a reorganization of the debtor corporation;

(b) The debtor's petition was not filed with the purpose of effecting a reorganization, but for the purpose of hindering and delaying its sole creditors, the appellants;

(c) No possible, feasible or practicable plan of reorganization could be proposed;

(d) Any plan that might be proposed would necessarily be speculative and impracticable; and

(e) The debtor's petition did not show honesty of purpose, motive or intent.

In its answering brief herein, appellee urges that: the appellants would not be affected by any reorganization; the debtor "seeks nothing more than a temporary breathing spell within which to liquidate its entire indebtedness" (Appellee's Answering Brief, page 70); and that debtor does not propose "to do any more than to extend the due date of the promissory notes (Appellee's Answering Brief, page 78). It is then argued by appellee that appellants' rights as creditors herein will not be affected by its reorganization.

IF APPELLANTS' RIGHTS AS CREDITORS ARE NOT TO BE AFFECTED BY ANY REORGANIZATION OF DEBTOR, THEN PETITION SHOULD HAVE BEEN DISMISSED.

As appellants are the only creditors of the debtor, it must follow, if this position of appellee be sound, that the contemplated reorganization would be such as would only affect stockholders or deal with the control or management of the corporation.

The internal affairs of a corporation are not subject to Federal legislation under the bankruptcy provisions of the Constitution unless they affect at least some creditor. See the following authorities:

Moore's Bankruptcy Manual, page 572,

stating the rule as follows:

> "It was felt by the drafters of the Chandler Bill that bankruptcy reorganization must deal with at least one class of creditors' rights in order to be constitutional. The power conferred by Article I, section 8, clause 4 of the Constitution,

giving Congress the power to enact 'uniform laws on the subject of bankruptcies throughout the United States' gives a broad power to govern debtor and creditor relationships. Stockholders' interests may be dealt with as incidental to the 'reorganization of a corporation's financial structure in the interests of its creditors'. If they alone are dealt with, it has been said that Congress may not interfere with the reserved power of the states giving exclusive jurisdiction over the internal affairs of state-created corporations.

Moreover, creditors' rights must be dealt with as a matter of statutory construction aside from the mandatory provision of § 216(1). Under § 77B *it could be argued that a plan was not filed in good faith if only stockholders' interests were sought to be modified.*" (Italics ours.)

See also dissenting opinion of Judge Cardozo in the case of

Chicago Title & Trust Co. v. Forty-One Thirty-Six Wilcox Bldg. Corpn., 302 U. S. 120, 82 L. ed. 147 at page 154,

as follows:

"A proceeding under § 77B is styled one to give effect to a corporate reorganization. Whatever its form or label, it derives its origin and vitality from the bankruptcy power. Continental Illinois Nat. Bank & T. Co. v. Chicago, R. I. & P. R. Co., 294 U. S. 648, 79 L. ed. 1110, 55 S. Ct. 595, 27 Am. Bankr. Rep. (N.S.) 715; Campbell v. Alleghany Corp. (C.C.A. 4th) 75 F. (2d) 947, 27 Am. Bankr. Rep. (N.S.) 504; re New Rochelle Coal & Lumber Co. (C.C.A. 2d) 77 Fed. (2d) 881, 28 Am. Bankr.

> Rep. (N.S.) 658, 29 Am. Bankr. Rep. (N.S.) 177. *Only because the remedy is traceable to that power is it constitutional and valid.* The notion is baseless that reorganization, even when initiated on the petition of the debtor, is solely or chiefly for the benefit of shareholders." (Italics ours.)

(The case in which the above language was used involved the right of a dissolved corporation to proceed under Section 77B). See also

> *In re Picadilly Realty Co.,* 78 Fed. (2d) 257 at 260,

wherein the court held:

> "It seems to us that this controversy is one wholly between the preferred and the common stockholders for control of the corporation, and we are satisfied that section 77B was not enacted for the purpose of adjusting such disputes where substantial claims of other and actual creditors are not involved.
>
> We believe the court erred in granting the petition, and the order appealed from is reversed with direction to the District Court to dismiss the petition."

APPELLEE'S OBJECTS DO NOT PRESENT A CASE FOR REORGANIZATION.

Appellee states its position herein as only seeking by this proceeding a "breathing spell" to meet its indebtedness or an extension of the maturity date of its notes to appellants. The very statement by appellee of its purposes herein demonstrates that what it seeks is simply a moratorium and not a reorganization.

Appellants contend that such relief is not to be afforded by the Act. The Act was primarily intended to prevent a minority of a corporation's creditors from obstructing reorganization. Its purpose was not the delaying of all creditors until a corporation might in some manner secure sufficient assets to pay its debts. The policy and object of the reorganization amendments are well set forth in the case of

Campbell v. Alleghany Corp., 75 Fed. (2d) 947, in the following language:

> "* * * and the very purpose of the statute was to provide means by which plans of reorganization approved by the court as fair and equitable might not be blocked by the opposition of non-assenting minorities."

If a moratorium is to be declared in favor of appellee and against appellants in the collection of their indebtedness, appellants' rights are certainly affected. If affected normally they would be required to consent to any such arrangement or receive in cash their claims (77B (b) (1)). Admittedly the debtor could not pay cash.

Directors Rowson and Gordon knew that appellants, the only creditors and owners of one-half of the stock of the debtor, would not consent to reorganization.

Appellee argues, however, that under subsection (b) (5) (d) a court has power to provide adequate protection for the realization by a dissenting class of creditors as will equitably and fairly provide for such creditors the value of their interest, claims or liens,

and that the court might conceivably approve its moratorium plan under this subdivision of the Act. Regarding this subsection, as now incorporated in the Chandler Act, *Moore's Bankruptcy Manual,* page 587, states as follows:

> "The fourth method of protection, which permits any method which the court may consider equitable, was eliminated from earlier drafts of the Chandler Bill. In the analysis of H. R. 12889 the recommendations of the National Bankruptcy Conference stated:
>
> > 'We have eliminated the provision which permits any other form of protection, as the court may consider equitable. We consider this provision unsound. In effect, it nullifies the three specific methods of protection, which experience in equity proceedings has demonstrated to be fully adequate to protect the interests of the minority. Besides, it has been recently held that this provision violates the Fifth Amendment. In re Tennessee Publishing Co. (C. C. A. 6th, 1936) 81 F. (2nd) 463. See also Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555.' "

Appellee's right to secure a moratorium in these proceedings must rest, if at all, upon the provisions of the above mentioned subsection. This subsection does not authorize a bankruptcy court to force upon all of the creditors of a bankrupt corporation an alteration of their rights against their will, nor does it authorize a bankruptcy court to grant moratoriums. No such

authority is to be found within the provisions of the Act, and if so construed the Act would be unconstitutional. See

In re Tennessee Publishing Co. (C. C. A. 6th, 1936), 81 Fed. (2d) 463.

The record discloses that debtor contemplates its "breathing spell" should extend over a period of two to three years. In order to consummate the payment of its indebtedness amounting to some $140,000.00 and interest, it had on hand, in quick assets at the date of the petition some $1200.00 in cash and some $4000.00 in other assets. The answering brief dwells to considerable extent upon the book values of the debtor's assets. Book values, however, are not of any assistance in liquidating creditors' claims. It also dwells to a considerable extent upon the testimony of Mr. White on cross-examination that he would not give an *option* on his interest in the property. Obviously what a creditor desires are not options or more promises to pay, but the keeping of promises already made. The record establishes conclusively that the only possibility of appellee ever liquidating the indebtedness due to the appellants is the continuation of the mine as a speculative enterprise. This means the depletion of its known ore reserves for further development in the hope that Mr. Gordon's prophecy might be realized and such ores continue to a depth of one thousand feet. Any such operation of the corporate property necessarily would be at the expense of appellants. Subsection (b) (5) (d) is not to be construed as allowing

speculation for the debtor's benefit at the hazard of the creditor. See

Price v. Spokane Silver & Lead Co., 97 Fed. (2d) 237,

which involved a mining corporation with book values something over $2,000,000.00 and an indebtedness of some $642,000.00. There was testimony from the officers of the corporation that they arrived at their valuations from various engineers' reports. The president testified that he thought the property worth several million dollars, otherwise he would not be there. The District Court confirmed a plan of reorganization which gave the stockholders an interest in the property. On appeal the court held as follows:

> "The court also erred in confirming the plan of reorganization, which made no distinction between creditors and stockholders, and placed them on a substantial parity. Unless the property of the debtor exceeded in value the amount of the claims of creditors, the stockholders had no interest to protect or preserve. In re 620 Church Street Building Corporation, 299 U.S. 24, 27, 57 S. Ct. 88, 89, 81 L. Ed. 16. We find nothing in the evidence, except generalizations and prophecies, to warrant any conclusion that the value of the assets of the debtor even equalled its liabilities, excluding its stock liability. To justify a retention of a stock interest by present stockholders of the debtor, it should appear that they have furnished an additional consideration or have an equity in the estate of the debtor after the rights of creditors are fully provided for. In re Barclay Park Corporation, 2 Cir., 90 F. 2d 595. See, also, In re

Day & Meyer, Murray & Young., Inc. 2 Cir., 93 F. 2d 657; O'Connor v. Mills, 8 Cir., 90 F. 2d 665, 667; Reading Hotel Corporation v. Protective Committee, 3 Cir., 89 F. 2d 53; Wayne United Gas Co. v. Owens-Illinois Glass Co., 4 Cir., 91 F. 2d 827. *Stockholders are not ordinarily entitled to participate in a plan of reorganization if the debtor is clearly insolvent.* Jamieson v. Watters, 4 Cir., 91 F. 2d 61, 63. * * *

'It is the duty of the court to scrutinize the plans of reorganization proposed for insolvent companies to make certain that the assets belonging to creditors are not by indirection diverted to stockholders. In re New York Rys. Corporation, 2 Cir., 82 F. 2d 739; In re Barclay Park Corporation, supra (2 Cir., 90 F. 2d 595).' In re Day & Meyer, Murray & Young, Inc., 2 Cir., 93 F. 2d 657, 659." (Italics ours.)

Reply Brief on Motion to Dismiss.

COURT'S OPINION OR CLERK'S MINUTE ORDER WAS NOT A FINAL APPEALABLE ORDER.

In the answering brief of appellee herein, it is contended that this proceeding should be dismissed. This contention is based upon the theory that the oral opinion of the court of July 9, 1938 was essentially a final order and that the time for appeal could not be extended by the making and entry of the order of July 13, 1938.

Appellants contend that no order was made on July 9, 1938, ruling upon or denying appellants' petition to dismiss, and that no order upon such matter was made or entered until the order of July 13, 1938.

Appellee urges that the ruling sustaining debtor's petition is a denial of appellants' petition to dismiss, and that no explicit ruling thereon was necessary, but is to be inferred from the ruling sustaining debtor's petition and appointing trustees.

We point out that the right of appeal from an order sustaining a debtor's petition is appealable as of right under section 24(a) of the Bankruptcy Act, while an order refusing to dismiss reorganization proceedings is appealable under an entirely different subsection, namely, section 24(b) of the Bankruptcy Act, and governed by an entirely different rule, in that it can only be taken on leave of the appellate court. This distinction is clearly pointed out in

Meyer v. Kenmore Granville Hotel Co., 297 U. S. 160, 80 L. ed. 557.

If appellants in the present proceeding had attempted to appeal from the court's oral opinion of July 9, 1938 under section 24(b), such an appeal would have been subject to dismissal because the District Court had never entered any final ruling upon appellants' Petition. Such ruling was necessary before the appellate court could have jurisdiction of the proceeding. See

Robinson v. Edler (C.C.A. Ninth), 78 Fed. (2d) 817,

wherein this Court on its own motion, and over the objection of counsel for both appellant and appellee, dismissed an appeal taken from a District Court's ruling which was held not to be a definite final ruling upon the matter involved.

No definite ruling in this case was made on appellants' petition until the court's order of July 13, 1938. The entire language of the court's opinion indicates that the opinion was not intended as a final order, but simply the opinion upon which an order could thereafter be based. It nowhere places the property in the hands of trustees, as contended for by appellee. It states:

> "With best wishes and success of the administration, that will be the order of the Court at this time. The Petition is approved and the *matter is referred* to the three trustees named. * * *".

Clearly, this is not language intended as a final order from which an appeal can be taken.

RULE OF CONFORMITY IS INAPPLICABLE.

Counsel for appellee cites a number of cases which are decisions of the Supreme Court of the State of Nevada, upon the question as to when an order, decision or judgment becomes final and appealable.

It requires no citation of authority to show that the rule of conformity has no application to appeals in bankruptcy cases. Moreover, the rule of conformity only applies when there is no express statute of the United States governing.

THE ORDER OF JULY 13, 1938, IS THE ONLY FINAL APPEALABLE ORDER IN THE PROCEEDING.

In appellants' opening brief, appellants urged that even though the opinion of the District Court of July 9, 1938 could by any construction be considered as an order, it was so amended and enlarged by the order signed by the Judge on July 13, 1938 that in any event the latter order constituted an amendment of the oral opinion and was therefore the only order from which an appeal could be taken by appellants.

Appellee urges that an extension of the time for appeal cannot be made by entering a new order, and appellee cites a number of cases holding that the right to appeal cannot be revived by a subsequent re-entry of the same order. In each of the cases cited by counsel it appears that the time for appeal had expired or that the term had expired. Such is not the situation in the case at bar. There is no question here of a

revival of the right of appeal. Here the District Court entered its order of July 13, 1938, only four days after its opinion. The time for appeal had not lapsed and the term had not expired. If the previous opinion constituted an order, then the later order is an amendment and enlargement thereof. At the time of the order of July 13, 1938 it was within the power of the District Court to change, enlarge, vacate or amend its opinion, and when it had done so the later order covering the same subject matter was the only order from which an appeal could be taken. See

Union Guardian Trust Co. v. Jastromb (C.C.A. Sixth), 47 Fed. (2d) 689.

Dated, Reno, Nevada,
May 26, 1939.

Respectfully submitted,
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